

Bill Deyo, Nixon Peabody LLP

Pension Obligation Bonds for California Local Agencies

September 12, 2004



NIXON PEABODY LLP
ATTORNEYS AT LAW

Nixon Peabody LLP

How are POBs different from G.O.s?

- ◆ Bonds issued to finance an “obligation imposed by law” are exempt from the constitutional debt requirements
- ◆ No referendum needed and not subject to debt limit
- ◆ Payable from the General Fund, not from levy of *ad valorem* taxes
- ◆ POBs are technically revenue refunding bonds
- ◆ POBs are unconditional and enforceable General Fund obligations
- ◆ Repayment is not limited to a special fund or revenue source

Obligation imposed by Law

- ◆ Judge-made legal doctrine that says certain bonds are not constitutional debt
- ◆ Theory: Bonds issued to pay an obligation imposed by law are not “discretionary” debt
- ◆ In the case of POBs, obligation to pay unfunded pension liabilities is deemed to be imposed by law
- ◆ Most issuers have no specific statutory authority to issue POBs
 - Exception: Joint Power Authorities

How can we issue POBs if there is no Statute authorizing them?

- ◆ Find an obligation imposed by law – to pay UAAL
- ◆ Create a debenture to evidence that obligation
- ◆ Authorize “refunding” bonds to pay down that debenture
- ◆ Have it validated by a court

What can I finance with POBs?

- ◆ Unfunded actuarially accrued liability (“UAAL”)
- ◆ Current pension obligations?
- ◆ Medical insurance benefits?

What kinds of obligations imposed by law are there?

- ◆ For a 1937 Act County
- ◆ For a Charter County or City with its own pension system
- ◆ For a member of PERS

What evidence of the UAAL is needed?

- ◆ An actuarial certification by the pension plan?
- ◆ Certification by an outside actuary?

Who may issue POBs?

- ◆ Counties
- ◆ Cities
- ◆ Special purpose districts
- ◆ School and Community College Districts?
- ◆ Conduit issuers

Validation Proceedings

- ◆ A proceeding in rem: It's us against the world
- ◆ Jurisdiction is obtained over all interested parties by publication of summons
- ◆ Promptness counts: Action must be brought within 60 days after adoption of bond resolution
- ◆ Protects from legal challenges, even on Constitutional grounds
- ◆ Caution: Publication invites the world to challenge your issue (you might lose!)

Disclosure

- ◆ "State of the Art" disclosure can now run 5-10 pages
- ◆ When the ultimate credit is the General Fund: Requires same disclosure as COPs or G.O. bonds
- ◆ For POBs it is appropriate to go into pension liability issues in greater detail
- ◆ PS: The impact of the pension liability on General Fund credit requires that pension liability be well disclosed on G.O. issues too
- ◆ A short word on a long-term commitment: Continuing disclosure

Tax Treatment

- ◆ Pension obligation bonds are always taxable
- ◆ Under the 1986 Tax Reform Act the interest on pension obligation bonds was explicitly made taxable
- ◆ State tax exemption